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(3) FEDERAL COMMUNICATIONS COMMISSION
(4) PUBLIC MEETING
(5) ON HIGH-COST UNIVERSAL SERVICE SUPPORT
(6) FOR AREAS SERVED BY RURAL CARRIERS AND RELATED
(7) ISSUES
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(12) PANEL 1
(13) SUPPORT IN AREAS SERVED BY RURAL CARRIERS AND
(14) THE DEFINITION OF "RURAL TELEPHONE COMPANY"
(15) PANEL 2
(16) BASIS OF SUPPORT FOR CETCs AND TRANSFERRED
(17) EXCHANGES
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(4) DAVID COLE, CENTURYTEL
(5) GENE JOHNSON, FAIRPOINT COMMUNICATIONS
(6) DENISE PARRISH, WYOMING OFFICE OF CONSUMER
(7) ADVOCATE
(8) DALE LEHMAN, ALASKA PACIFIC UNIVERSITY
(9) LEE SELWYN, ETI
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(1) APPEARANCES
(2)
(3) JOINT BOARD
(4) COMMISSIONER KATHLEEN Q. ABERNATHY
(5) COMMISSIONER KEVIN J. MARTIN
(6) COMMISSIONER THOMAS DUNLEAVY
(7) COMMISSIONER ROBERT NELSON
(8) COMMISSIONER LILA JABER
(9) CONSUMER ADVOCATE BILLY JACK GREGG
(10)
(11) PANELISTS I
(12) RICH COIT, SOUTH DAKOTA INDEPENDENT TELEPHONE
(13) COALITION
(14) PAUL GARRETT, CELLULAR TELECOMMUNICATIONS
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(16) JEFF REYNOLDS, PARRISH, BLESSING & ASSOCIATES
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(18) JOEL LUBIN, AT&T
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(20) DALE LEHMAN, ALASKA PACIFIC UNIVERSITY
(21) LEE SELWYN, ETI
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(1) * * *
(2) COMMISSIONER ABERNATHY: My name is
(3) Kathleen Abernathy. I'm the FCC Commissioner.
(4) I want to welcome everybody to today's en banc
(5) where we are going to focus on possible
(6) reforms to the universal service support
(7) mechanism for high-cost rural areas.
(8) As all of us recognize, universal
(9) service is one of the cornerstones of the
(10) Federal Communications policy, and Congress
(11) did make it a top priority in the 1996 Act.
(12) So, it's vital for us to ensure that the
(13) program remains sustainable over the long
(14) haul, that it operates fairly and efficiently,
(15) and that we are addressing problems before
(16) they become critical. So, what we're looking
(17) at today is how do you calculate and receive
(18) high-cost universal service support.
(19) And the first panel will address the
(20) question of whether high-cost support for
(21) rural carriers should continue to be based on
(22) embedded costs, should be transitioned to
(23) forward-looking costs as under the non-rural
(24) support mechanism, or are there other
(25) alternatives available.

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- (1) I think the Commission concluded
 (2) several times in the past that a
 (3) forward-looking cost methodology was an
 (4) optimal choice, but refrained from
 (5) implementing such an approach based on
 (6) concerns about the reliability of the cost
 (7) models that you would have for rural areas.
 (8) And I know many of those questions remain. At
 (9) the Joint Board now, we are revisiting this
 (10) fundamental question, and I'm sure that our
 (11) panelists will give us a lot of insight into
 (12) the strengths and weaknesses of the competing
 (13) proposals. What we've found is that these en
 (14) banc hearings provide a unique opportunity for
 (15) us to hear from all parties side by side and
 (16) kind of address many of the questions that
 (17) come up.
 (18) The first panel also is going to
 (19) address the definition of rural carrier. Some
 (20) have argued that holding companies that own
 (21) and operate rural telephone companies in
 (22) different parts of the United States should be
 (23) required to aggregate those operations into a
 (24) single study area for purposes of calculating
 (25) universal service support. And essentially

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- (1) panel will address the FCC rule that limits
 (2) support for acquired exchanges to the amount
 (3) that the seller received, whether or not that
 (4) should be revisited.
 (5) Now, before we get on to the
 (6) substance of our first panel, I want to begin
 (7) my offering a heartfelt thank you for all of
 (8) our esteemed panelists for traveling to
 (9) Nashville at their own expense to help the
 (10) Joint Board grapple with these very, very
 (11) important issues. You've given us advance
 (12) presentation materials that are informative.
 (13) We're going to be able to hear from you. We
 (14) really do appreciate this; it's essential. We
 (15) need your help as we struggle with these very
 (16) complicated, complex issues. And so, thank
 (17) you.
 (18) And I also want to take a moment to
 (19) recognize two colleagues who are departing
 (20) from public service and, as a result, from
 (21) their participation on the Joint Board. It's
 (22) Bob Rowe from Montana and Lila Jaber from
 (23) Florida.
 (24) Bob and Lila have been part of
 (25) the Joint Board since I joined a little over

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- (1) what we would be doing is treating these
 (2) holding companies the same as non-rural
 (3) carriers. So, our panelists are going to
 (4) discuss the merits of the current approach,
 (5) where we do not engage in that kind of
 (6) analysis versus some of the potential
 (7) alternatives.
 (8) Then we will have a short break. We
 (9) will need a break. And then we'll move to our
 (10) second panel where we're going focus primarily
 (11) on the basis of support for competitive ETCs.
 (12) Incumbent carriers have long argued that
 (13) wireless carriers and other competitive ETCs,
 (14) which is eligible telecom carriers, should
 (15) receive their support based on their own
 (16) embedded cost rather than on the incumbent's
 (17) cost.
 (18) Competitors, by contrast, generally
 (19) argue that incumbents and competitors must
 (20) receive identical support, whether it's based
 (21) on forward-looking costs, the lowest cost,
 (22) provider's costs or any other measure. So,
 (23) we're going to explore all of those arguments
 (24) in detail.
 (25) And I think, in addition, the second

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- (1) three years ago. They have been instrumental in
 (2) helping this Joint Board, I think, cover a
 (3) tremendous amount of material, controversial,
 (4) complex issues that folks said we'd never be
 (5) able to reach consensus on and we did.
 (6) Bob was instrumental in urging us
 (7) to adopt this en banc approach, which we did.
 (8) It's been very, very successful and helpful. I
 (9) want to thank Bob for that, for his good humor,
 (10) for his wit, his knowledge of the details. And
 (11) it's going to be a loss that you will no longer
 (12) be a part of the Joint Board and a loss, I
 (13) think, for the public. But I wish you all the
 (14) best in whatever you do next. I'm assuming we
 (15) will continue to hear from you about your
 (16) thoughts on many of these issues, so thank you
 (17) for all your help.
 (18) And Lila also has just been a
 (19) tremendous asset on this Joint Board, very good
 (20) at reconciling some of the issues between the
 (21) larger states, the rural states and the non-rural
 (22) states, and how you balance those concerns; a
 (23) friend who has helped as we've struggled through
 (24) some of these issues, and who has helped me
 (25) understand the workings of NARUC.

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- (1) And I wish them both the best.
- (2) I'm sorry they're leaving because we have a nice
- (3) little family. I got very comfortable. The
- (4) good news is that NARUC has nominated some
- (5) excellent replacements in time for them to
- (6) attend today's event. We've got Elliott Smith
- (7) of Iowa. I want to thank Elliott for being
- (8) willing to step into some issues and to deal
- (9) with some very controversial and complex issues.
- (10) They didn't tell you that, I'm sure. And Ray
- (11) Baum of Oregon - Ray, thank you, also.
- (12) They've both been nominated by
- (13) NARUC. There will be a formal process through
- (14) the FCC and then they will formally join the
- (15) Board very soon.
- (16) And, finally, I want to give an
- (17) opportunity to my colleagues to be able to talk
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- (18) a little bit about what we're doing here and why
- (19) we're exploring these issues. And then we'll
- (20) move right to the first panel.
- (21) My first colleague that I want to
- (22) introduce here is via phone, and that's Jonathan
- (23) Adelstein. He's a little bit busy meeting with
- (24) some important folks today.
- (25) Jonathan, are you on the phone?

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- (1) COMMISSIONER ADLESTEIN: I sure am.
- (2) Can you hear me?
- (3) COMMISSIONER ABERNATHY: Yes. We can
- (4) hear you just fine. So, if you want to make a
- (5) few opening remarks, I appreciate you taking
- (6) the time to get on the phone. And I'm sorry
- (7) you couldn't be with us today.
- (8) COMMISSIONER ADLESTEIN: Thank you,
- (9) Commissioner Abernathy. You've done a great
- (10) job of organizing this, together with the
- (11) Joint Board's staff, folks from the Wireline
- (12) Competition Bureau here, and, of course, our
- (13) excellent state staff.
- (14) I think this is a great on banc
- (15) hearing you've got organized. I'm really
- (16) disappointed I can't be there. I really wish
- (17) I could be in Nashville today, not just
- (18) because I love the Grand Ole Opry. I had my
- (19) tickets; I was ready to go. But there's some
- (20) pressing business here in Washington that you
- (21) may have heard about that keeps me from being
- (22) there. But I'm listening to as much of this
- (23) by audio as I possibly can but, as you
- (24) indicated, I might get called away. There's
- (25) quite a few things going on here today.

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- (1) I do want to join you, Chairman
- (2) Abernathy, in thanking Bob Rowe and Lila Jaber
- (3) for their contributions to the Joint Board. I
- (4) really enjoyed working with both of them so
- (5) much, and I really appreciated the expertise
- (6) and the contributions that they brought to
- (7) this Joint Board. They've been tremendous and
- (8) we're going to miss them dearly. But I'm also
- (9) very excited about working with Commissioners
- (10) Smith and Baum going forward. I think they're
- (11) going to make a great addition, but we'll miss
- (12) our departing colleagues dearly.
- (13) I'd also like to extend a particular
- (14) thanks to the remarkable group of panelists
- (15) who made the time to participate today. I'm
- (16) glad to see that Rich Colt will be there from
- (17) South Dakota so that South Dakota will be
- (18) represented even if I can't make it. All the
- (19) panelists, including Rich and the others,
- (20) bring a rich wealth of experience that will
- (21) really enrich us on these issues. And I think
- (22) together they reflect a diversity of issues
- (23) that we've got to consider in this proceeding.
- (24) While the details at issue in this
- (25) proceeding are really complicated, I can't

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(1) overemphasize the importance of the task at
 (2) hand. I've spoken a lot about these issues,
 (3) and clearly Congress has recognized the
 (4) importance of ensuring that we maintain a
 (5) specific, sufficient, and predictable
 (6) universal support mechanism. Putting that
 (7) directive into concrete terms is a lot of work
 (8) for us and will have an impact going forward
 (9) for generations to come on the ability of
 (10) providers in rural America to deliver high
 (11) quality, innovative services. And it's going
 (12) to affect the overall economy in development
 (13) of the marketplace in those areas.
 (14) I'm really looking forward to the
 (15) discussions here. What I can't hear today
 (16) I'll look at the record. And, once again, I
 (17) really want to send my thanks to all of you
 (18) involved in the effort to put this together
 (19) and tackle these important issues today.
 (20) COMMISSIONER ABERNATHY: Thank you
 (21) very much. And we completely understand and,
 (22) needless to say, this is just the beginning of
 (23) what these issues - it's just the opening
 (24) round of comments. So, stay tuned, Jonathan,
 (25) and good luck.

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(1) And, I think we'll start with you,
 (2) Commissioner Martin.
 (3) COMMISSIONER MARTIN: Thank you.
 (4) Thank you for organizing the panel and thank
 (5) all the panelists for making the trip all of
 (6) the way out here and for extending their stay
 (7) here at NARUC.
 (8) I also do want to thank and begin by
 (9) recognizing the efforts of Bob Rowe and Lila
 (10) Jaber over the last few years. They've
 (11) certainly been instrumental in a lot of the
 (12) decisions we've done. I personally have
 (13) benefitted greatly from their insight and
 (14) their wisdom as we try to address several of
 (15) these contentious issues. And I think they've
 (16) done a pretty good job of public service, not
 (17) only on this Joint Board but in serving the
 (18) citizens of their states and serving all of
 (19) the citizens in the country by their efforts
 (20) here. So, I do want to wish them the best of
 (21) luck, and we'll continue to miss both of you
 (22) as we go forward.
 (23) As Jonathan mentioned, Congress has
 (24) required the Commission to ensure that we have
 (25) a sufficient universal service support

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(1) mechanism to make sure that all of rural
 (2) America and all of rural Americans have the
 (3) ability to obtain service at rates that are
 (4) relatively comparable to those of citizens
 (5) living in urban areas. And I think that one
 (6) of the core goals during my time at the
 (7) Commission has been to ensure that we have the
 (8) connectivity to the 21st century networks for
 (9) all Americans, including those who live in
 (10) rural areas.
 (11) Today's en banc is certainly going to
 (12) address some of the contentious and critical
 (13) issues for how we go about achieving that goal
 (14) and the future of universal service and the
 (15) support for those networks.
 (16) As I have said before and in private
 (17) meetings with many of you and in some of my
 (18) previous statements, I do have concerns and am
 (19) troubled by some of the Commission's potential
 (20) to request that the Joint Board consider
 (21) whether a forward-looking economic cost model
 (22) is more appropriate than for high cost and for
 (23) non-rural telephone companies. When the
 (24) Commission explicitly adopted that mechanism
 (25) for the non-rural companies, they explicitly

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(1) stated that might not be an appropriate
 (2) mechanism for rural companies.
 (3) And, indeed, the Rural Task Force has
 (4) made clear that - one of their cornerstone
 (5) concepts of their recommendation was the
 (6) decision to recommend the continued use of the
 (7) embedded cost mechanism rather than the
 (8) Commission's forward-looking cost model for
 (9) sizing universal support for rural carriers.
 (10) And I continue to be concerned about the
 (11) implications for them.
 (12) So, I'm anxious to have the dialogue
 (13) with the panel today to further understand
 (14) their views and the options of the Commission.
 (15) And I equally think that the second panel with
 (16) regard to ETCs will be an important discussion
 (17) for the Joint Board. Again, I think that many
 (18) of the issues related to the ETCs have been
 (19) widely discussed among the Joint Board, and I
 (20) think there's many concerns about the level of
 (21) scrutiny that the Commission should be
 (22) applying to the ETCs and also how we should be
 (23) distributing resources there as well. So, I
 (24) think we will have a spirited, I'm sure,
 (25) debate on the first and second panel.

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- (1) With that, I'll turn it over to my
- (2) other colleagues.
- (3) COMMISSIONER ABERNATHY: Thank you,
- (4) Commissioner Martin.
- (5) Now, we'll hear from Commissioner
- (6) Dunleavy.
- (7) COMMISSIONER DUNLEAVY: Thank you
- (8) very much, Madam Chairman.
- (9) And I'd like to echo, of course,
- (10) Commissioner Abernathy comment's and
- (11) Commissioner Adelstein's comments and
- (12) Commissioner Martin's comments relative to the
- (13) contributions that were made by both Bob Rowe
- (14) and Lila Jaber. I'll tell you that I for one
- (15) will sorely miss the good counsel and help
- (16) that was provided so freely and generously on
- (17) every question. They were never too busy to
- (18) help out wherever they were asked. They will
- (19) be sorely missed.
- (20) And I think we are, likewise, very
- (21) fortunate to have the opportunity to be joined
- (22) here by Elliott Smith from Iowa, who is doing
- (23) a bang-up job on the ICC task force for the
- (24) telecom committee and NARUC; and, of course,
- (25) Ray Baum, who will bring - who does bring a

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- (1) tremendous amount to the table.
- (2) Lila and Bob are big shoes to fill,
- (3) but I'm sure that over time that that will -
- (4) COMMISSIONER JABER: His are bigger.
- (5) COMMISSIONER DUNLEAVY: - that will
- (6) take place.
- (7) In any event, I think that it
- (8) probably goes without saying that none of us
- (9) here today questions the importance of
- (10) universal service and the issues before us.
- (11) I'm sure, too, that we would all agree that
- (12) our goal is, as the Act directs us, to ensure
- (13) that comparable telecommunications services
- (14) are available in all regions of the country at
- (15) reasonably comparable rates.
- (16) Now, we might even all agree that we
- (17) want new telecommunications capabilities, new
- (18) technology to become available in all areas in
- (19) a very timely fashion. Those are all in
- (20) agreement. And there is, as we have heard
- (21) repeatedly at a variety of meetings and panels
- (22) at the NARUC convention during the week, that
- (23) there is a growing concern over the
- (24) sustainability of the current universal
- (25) service regime in general and its high-cost

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- (1) mechanism in particular. And this suggests to
- (2) me that perhaps more of the same is simply not
- (3) an acceptable answer. Therefore, we're going
- (4) to need to find and agree on a new approach to
- (5) achieving our common goal.
- (6) Now, unfortunately, after reviewing
- (7) the positions offered and the comments in this
- (8) proceeding and the statements of - some
- (9) statements of some of our panelists, I sense
- (10) that we haven't yet made great progress
- (11) towards finding and agreeing on any new
- (12) approaches. Indeed, I have the sense that we
- (13) don't even agree on the role high-cost support
- (14) should play in achieving universal service.
- (15) And so, I sincerely hope that today's
- (16) en banc will give us the opportunity to find
- (17) and explore some new ideas. And I hope that
- (18) instead of what so often happens here in our
- (19) world that instead of finger pointing and name
- (20) calling, that we could use our limited time
- (21) together to discover areas of agreement that
- (22) will help all of us along our path to
- (23) universal service reform and achievement of
- (24) all of our common goals.
- (25) And now, in the interest of

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- (1) preserving time and knowing that I've already
- (2) said too much, I will thank you, Madam
- (3) Chairman, and turn it over.
- (4) COMMISSIONER ABERNATHY: And now I
- (5) want to welcome Commissioner Bob Nelson to his
- (6) first en banc. Thanks for joining us. He's
- (7) been, already, an important part of the team
- (8) as we prepared for this proceeding.
- (9) COMMISSIONER NELSON: Thank you. And
- (10) I do also want to extend my remarks regarding
- (11) Lila Jaber and Bob Rowe. I echo the
- (12) sentiments of Commissioners Abernathy, Martin,
- (13) Adelstein, and Dunleavy. They led the way for
- (14) me and others to join this Joint Board,
- (15) including Elliott Smith and Ray Baum, and have
- (16) set very fine examples for us to follow.
- (17) In terms of what we're going to be
- (18) hearing today, I agree with Tom that, you
- (19) know, perhaps the written comments so far have
- (20) not coalesced behind a unified approach to the
- (21) issues that have been teed up in this proceeding.
- (22) But I am certainly eager to hear the thoughts
- (23) of the panelists today regarding the
- (24) sustainability of the high-cost fund and how
- (25) that can be best addressed through the goals

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- (1) that we're offering today.
- (2) So, with that, I'll close my remarks.
- (3) COMMISSIONER ABERNATHY: And now
- (4) we'll hear from Billy Jack Gregg, Consumer
- (5) Advocate from West Virginia.
- (6) CONSUMER ADVOCATE GREGG: Ditto to
- (7) Bob and Lila. Good luck, God speed in your
- (8) transition to civilian life.
- (9) In my entire time on the Joint Board
- (10) the issues that we faced remain the same.
- (11) It's whether we're going to support access or
- (12) excess. Unlike my fellow commissioners, when
- (13) I read the comments, I did see a broad
- (14) agreement among the parties. It was that
- (15) there is abuse in the system, and it's the
- (16) support that the other guy is getting.
- (17) I hope that as we talk about trying
- (18) to harmonize the currently existing rural and
- (19) non-rural support mechanisms, that we don't
- (20) lose sight of the more distant future and what
- (21) an appropriate universal service support
- (22) system will be in a broadband age that is
- (23) rapidly coming down upon us. And I'm going to
- (24) take any opportunities I have today to elicit
- (25) suggestions from the panelists on steps we can

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- (1) start to take now to transition the universal
- (2) service fund to one that will be appropriate
- (3) in the broadband age. Thank you.
- (4) COMMISSIONER ABERNATHY: Thank you
- (5) very much, Billy Jack.
- (6) And then finally we'll hear from
- (7) Commissioner Lila Jaber from Florida.
- (8) COMMISSIONER JABER: Thank you,
- (9) Commissioner.
- (10) I think that I can take the liberty
- (11) and speak on Bob's behalf as well -
- (12) Commissioner Rowe's behalf that this is an
- (13) awesome body that has been led by a fantastic
- (14) manager/leader in Kathleen Abernathy. I think
- (15) Bob and I can attest to the fact that
- (16) certainly the criticism that the Joint Board
- (17) moves slow has been put to bed under your
- (18) leadership, Kathleen. And I just want to stop
- (19) and recognize you for your incredible ability
- (20) to have the body reach consensus when we could
- (21) reach consensus and be concise about the areas
- (22) that we just simply disagree on in a manner
- (23) that is timely and that has afforded an
- (24) opportunity for folks to respond to different
- (25) options that we put on the table. And I give

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- (1) you complete credit for that.
- (2) And I also want to recognize
- (3) Commissioners Martin and Adelstein for their
- (4) incredible ability to have us think through
- (5) very tough issues. And, frankly, this topic
- (6) in particular, both Kevin and Jonathan have
- (7) been voices and, before you, Commissioner
- (8) Coppe, who started out on the board when I got
- (9) on the board and Bob was on the board - just
- (10) for your thoughtful, deliberative manner and
- (11) requesting that we think through all issues
- (12) and being the voices of reason when we
- (13) desperately needed that.
- (14) This is an incredible opportunity,
- (15) commissioners and folks in the audience, to
- (16) think ahead while times that - there are
- (17) state commissioners leaving. And, certainly,
- (18) Bob and I will miss our state colleagues on
- (19) the Joint Board and we recognize you for your
- (20) effort. I see it as a fantastic opportunity
- (21) to move forward. And I think Elliott and Ray
- (22) are two people that can help in that regard
- (23) and my compliments to the selection.
- (24) But I also think it's an opportunity
- (25) to move the universal service program forward.

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- (1) Like all things in all programs, certainly
- (2) government-type programs, there are
- (3) inefficiencies that have to be addressed.
- (4) That's not to take away from the success of
- (5) the program. Billy Jack referenced that a
- (6) little bit earlier, that we have heard that
- (7) there are reforms, and certainly we see
- (8) directly that there are reforms that need to
- (9) take place. And we are excited today to hear
- (10) what those reforms should be.
- (11) But I hope we also remember that this
- (12) is a well-founded, successful program that
- (13) needs to be improved upon and become even more
- (14) sustainable. And the questions I have today
- (15) really go toward trying to figure out what
- (16) these improvements are. In my questions,
- (17) you'll see a theme. I'm really focused on the
- (18) definition of a rural telephone company and
- (19) how that plays a part in this debate going
- (20) forward.
- (21) My compliments, again, to the entire
- (22) group. I wish you the best of luck and I hope
- (23) our paths cross again in some form or fashion.
- (24) We'll see you soon.
- (25) COMMISSIONER ABERNATHY: Thank you

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- (1) very much, Commissioner Jaber.
- (2) And now we'll move toward to the
- (3) panel. I want to emphasize what we would
- (4) love, because we do have your written
- (5) materials, which we have reviewed. If you
- (6) could keep it down to three minutes, which I
- (7) know is really tough – but that's because we
- (8) do want to hear them all, but we want to
- (9) direct specific questions at you.
- (10) If you could also go ahead – we'll
- (11) start with Rich Colt and work our way down the
- (12) line. If you go ahead and introduce yourself
- (13) very briefly, make your presentation. And
- (14) then as questions are asked, if you could
- (15) identify yourself, because we have a record
- (16) that's going to go into the docket. And we
- (17) want to be able to identify which parties are
- (18) supporting various proposals.
- (19) So, we'll start with Rich Colt of
- (20) South Dakota Telecommunications Association.
- (21) MR. COIT: Thank you, Madam Chairman,
- (22) members of the committee – or the board. I
- (23) would just like to thank you for inviting me
- (24) today. I look at this as an honor. And I
- (25) think, looking at other members of the panel,

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- (1) we will have a great discussion today. And
- (2) hopefully we'll get closer to where we need to
- (3) be to get to where we need to be in the
- (4) future.
- (5) I would just like to spend just a few
- (6) minutes here just giving you a little
- (7) background. I am here today representing the
- (8) South Dakota Telecommunications Association
- (9) and also the National Telephone Cooperative
- (10) Association.
- (11) With respect to SDTA, as an
- (12) organization, currently we have 29 member
- (13) companies, all of which are rural telephone
- (14) companies. Twelve of those companies are
- (15) member-owned cooperatives, and 13 of those
- (16) companies we would consider private companies,
- (17) companies that are either owned by family
- (18) businesses – some of those companies are also
- (19) owned by some of the cooperatives, are
- (20) subsidiaries of some of the cooperatives.
- (21) We have three municipal telephone
- (22) companies that are members, and we also have a
- (23) tribally owned telephone company, Cheyenne
- (24) River Sioux Tribe Telephone Authority.
- (25) In terms of the service that those

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- (1) companies provide in South Dakota, they serve
- (2) approximately 152,000 access lines spread
- (3) across 61,000 square miles of South Dakota.
- (4) That accounts for approximately 75 to 80
- (5) percent of the state's geography. And our
- (6) companies serve all or part of eight of nine
- (7) Native American reservations in South Dakota.
- (8) To give you an idea of the true rural
- (9) nature of the companies, the three largest
- (10) communities served by the SDTA member
- (11) companies are Brookings, South Dakota, which
- (12) is a town in the eastern part of the state
- (13) with a population of about 18,504; Hot Springs
- (14) with a population of 4,129. And the third
- (15) largest is Winter, South Dakota, with a
- (16) population of 3,137. So, that will give you
- (17) an idea of the types of communities we serve.
- (18) Obviously, our companies serve
- (19) incorporated and unincorporated communities.
- (20) Some of the unincorporated communities, they
- (21) probably don't even have populations of 20.
- (22) So, we are very sparse in terms of the area
- (23) that we serve. Looking at the population
- (24) density of the counties that are served by
- (25) SDTA member companies, the average density is

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- (1) four persons per square mile. Eleven of those
- (2) counties have less than two persons per square
- (3) mile.
- (4) As a group of companies, as someone
- (5) who's been involved in the telecommunications
- (6) industry and the rural industry in South
- (7) Dakota for a fair number of years, I can say
- (8) that we're proud as an industry of the
- (9) investments that the rural carriers have made
- (10) in South Dakota.
- (11) As a group, they've deployed almost
- (12) 8,000 miles of fiber across the state, which
- (13) includes a backbone network today utilizing
- (14) SONET and EWEM technology. These facilities
- (15) have allowed us to extend frame relay and ATM
- (16) services to any requesting school in our
- (17) service areas. That was done in large part in
- (18) partnership with the Digital Dakota Network,
- (19) which is an entity, a network, of leased
- (20) facilities established by the State of South
- (21) Dakota for use by schools throughout the
- (22) state.
- (23) We have – looking at the local
- (24) facilities' deployment, local exchange
- (25) facilities' deployment, any upgrades of the

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- (1) loop facilities over the past five or six
- (2) years or so, we have been able to reach 250
- (3) communities with DSL services. VDSL is also
- (4) now available in more than 50 of those
- (5) communities.
- (6) There are a number of issues that are
- (7) before the board today. I suspect that
- (8) *probably much of the discussion will be on*
- (9) *forward-looking cost models versus embedded*
- (10) *cost models. As you can tell from our written*
- (11) *comments, we have indicated support for the*
- (12) *embedded cost models. We've - you will hear*
- (13) *challenges today to - and criticisms of both*
- (14) *of those methods, and I would just ask the*
- (15) *Joint Board as you evaluate those criticisms,*
- (16) *evaluate alternatives to address the issues*
- (17) *that are presented - first and foremost, we*
- (18) *believe that the Joint Board needs to,*
- (19) *whatever it adopts, adopt a mechanism that is*
- (20) *consistent with promoting continued*
- (21) *infrastructure investment.*
- (22) *If you look at the current method*
- (23) *this is utilized, we believe it certainly has*
- (24) *been consistent with that. In looking at all*
- (25) *the investment that has been made in South*

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- (1) Dakota, I think in large part we've been able
- (2) to do what we've done as a result of the
- (3) mechanisms that are in place today. So, in
- (4) our view, looking at - you know, there are
- (5) standards in the Act: specific, sufficient,
- (6) predictable. But first and foremost, look at
- (7) what the impact on the investment is going to
- (8) be, because if you don't have that investment,
- (9) that continued investment, you're certainly
- (10) not going to be able to preserve advanced
- (11) universal service, which is the general goal
- (12) that's set forth in the Act. Thank you very
- (13) much.
- (14) COMMISSIONER ABERNATHY: Very good.
- (15) Thank you very much.
- (16) Now, we'll move on to Paul Garnett
- (17) from the CTIA.
- (18) MR. GARNETT: My name is Paul Garnett
- (19) from CTIA. We represent, as you know, all of
- (20) the major providers of mobile wireless
- (21) services in this country in addition to a
- (22) number of small- and medium-sized carriers,
- (23) manufacturers and applications providers.
- (24) First of all, I'd like to thank the
- (25) Joint Board for including CTIA on this panel.

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- (1) Increasingly, the wireless industry is
- (2) contributing to the universal service
- (3) mechanisms, and we also increasingly are
- (4) receiving high-cost support. So, we feel it's
- (5) important that we be included in whatever
- (6) debate there is about the future of the
- (7) high-cost support mechanisms and other
- (8) universal service debates.
- (9) CTIA and its member companies think
- (10) that this proceeding along high-cost and
- (11) contribution-related proceedings and the
- (12) intercarrier compensation proceeding together,
- (13) will have a significant impact on the way
- (14) services - first of all, whether and how
- (15) services are deployed, both information
- (16) services and telecommunications services are
- (17) deployed in rural areas in the foreseeable
- (18) future. So, you have a significant task
- (19) before you.
- (20) In our comments CTIA has presented a
- (21) proposal for reforming the high-cost
- (22) mechanisms. And in developing that proposal,
- (23) we tried to do exactly what Billy Jack Gregg
- (24) described, which is to really try to have as
- (25) long a time period, as long a horizon as

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- (1) possible in developing those proposals; not to
- (2) just look at what the high-cost mechanisms
- (3) should look like in the next couple years, but
- (4) what the mechanisms potentially should look
- (5) like ten years from now when we really have a
- (6) different industry.
- (7) And we considered a lot of different
- (8) things. We considered keeping the embedded
- (9) cost system, competitive bidding, direct
- (10) consumer subsidy, forward-looking cost. We
- (11) considered all those things, and we sat down
- (12) with our member companies over a series of
- (13) calls, just like I know you will go through
- (14) this process on Joint Board calls and among
- (15) yourselves, tried to come up with a proposal
- (16) that basically moves us forward into the
- (17) future and has a mechanism in place that
- (18) basically accommodates what's been happening
- (19) in the industry.
- (20) Taking a step back, in developing our
- (21) proposal, we looked first at the Act, which
- (22) requires that the support mechanisms be - as
- (23) you have all mentioned - predictable,
- (24) sufficient, specific; that the mechanisms
- (25) focus on consumers first and foremost; and

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- (1) ensure that consumers in rural high-cost areas
- (2) have access to the same types of services and
- (3) the same options that are available to
- (4) consumers in low-cost urban areas.
- (5) Beyond the basic framework provided
- (6) in the Act, we also came to agreement on some
- (7) core principles for reform. The first thing
- (8) that we agreed on is that whatever system is
- (9) in place needs to be administratively as
- (10) simple as possible. We all agreed that the
- (11) current system has way too much administrative
- (12) complexity. The second thing we agreed on is
- (13) that whatever system is in place must
- (14) encourage and reward efficiency over time.
- (15) And thirdly, we agreed that whatever system is
- (16) in place has to appropriately target support
- (17) to high-cost areas. It's not enough for the
- (18) mechanisms to calculate what may on average be
- (19) high cost. You have to make sure that the
- (20) support, whatever it is, actually gets spent
- (21) and targeted to those high-cost areas that
- (22) need it.
- (23) So, with that in mind and having
- (24) considered a whole number of possibilities, we
- (25) ultimately agreed that the best system for

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- (1) achieving those goals is one based on
- (2) forward-looking economic cost, which is what
- (3) the Commission and the Joint Board has come to
- (4) agreement on in several instances in the past.
- (5) So, here's our proposal. Basically,
- (6) the way we have laid it out in our comments is
- (7) that over time we transition from our current
- (8) system of five high-cost support mechanisms
- (9) plus two derivative high-cost mechanisms
- (10) created under the high-cost loop mechanism
- (11) down to one high-cost mechanism that
- (12) calculates support based on forward-looking
- (13) economic costs. That mechanism would target
- (14) support to wire centers. Initially, it would
- (15) base support for both incumbents and
- (16) competitive ETCs on the incumbent LEC's
- (17) forward-looking cost for a specific wire
- (18) center. Ultimately, you would develop a
- (19) mechanism that would calculate support for
- (20) specific areas based on the most efficient
- (21) technology in that specific geographic area,
- (22) whether that's wireless or wireline or
- (23) whatever.
- (24) Under whatever mechanism is in place,
- (25) though, we think it's critical that equal

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- (1) per-line support be available on a
- (2) non-discriminatory basis. So, whatever the
- (3) support is based on, whether on wireless costs
- (4) or on wireline costs, support should be equal.
- (5) How do we get there? It's not
- (6) something that would happen overnight. It
- (7) would have to happen over a number of years.
- (8) We would transition, first, big carriers to
- (9) the forward-looking support mechanism. We
- (10) would need to make a number of changes to the
- (11) forward-looking mechanism in order to get
- (12) smaller carriers on it. We would have to get
- (13) rid of state-wide averaging, change the
- (14) benchmarks possibly.
- (15) But two things that definitely will
- (16) need to happen in order to get us there, first
- (17) of all, the Joint Board and the Commission are
- (18) going to have to devote resources to making
- (19) this happen. And I think one of the big
- (20) knocks on the forward-looking mechanism in the
- (21) past is that the Commission did not devote
- (22) appropriate resources to keeping that
- (23) mechanism up-to-date and keeping inputs to the
- (24) mechanism up-to-date. The rules should be
- (25) codified to require frequent updates to the

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- (1) mechanism, whatever it is. And the Commission
- (2) needs to set firm deadlines for that
- (3) transition.
- (4) And we look forward to discussing
- (5) this proposal further with you.
- (6) COMMISSIONER ABERNATHY: Thank you
- (7) very much, Paul.
- (8) And now we'll move on to Jeff
- (9) Reynolds of Parrish, Blessing, and Associates.
- (10) MR. REYNOLDS: Good afternoon. My
- (11) name is Jeffrey Reynolds. I'm a principal in
- (12) the economic consulting firm of Parrish,
- (13) Blessing, and Associates and testifying today
- (14) on behalf of the Independent Telephone and
- (15) Telecommunications Alliance. ITTA is an
- (16) organization of mid-sized telephone companies
- (17) serving thousands of rural communities. ITTA
- (18) member companies serve a large proportion of
- (19) the rural lines in the nation.
- (20) ITTA appreciates the opportunity to
- (21) offer this testimony on the continuing need to
- (22) provide specific, predictable, and sufficient
- (23) universal service, high-cost support for rural
- (24) carriers. ITTA urges you to recommend that
- (25) the FCC continue to use the statutory

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- (1) definition of rural telephone company to
- (2) determine eligibility for high-cost support.
- (3) ITTA advocates that the FCC continue to
- (4) calculate support on a study-area basis for
- (5) rural telephone companies. ITTA also asks you
- (6) to recommend retaining the use of embedded
- (7) actual cost in calculating support level for
- (8) rural carriers.
- (9) The use of the statutory definition
- (10) of rural telephone company to determine
- (11) eligibility for rural universal service
- (12) support has worked well. This definition
- (13) contains multiple criteria for a reason. No
- (14) single attribute could adequately define
- (15) carriers serving rural areas. The record in
- (16) this proceeding confirms that rural areas
- (17) should be treated differently than non-rural
- (18) areas. There also are substantial differences
- (19) among rural areas. Study areas served by
- (20) rural carriers vary significantly in many
- (21) aspects, including line density, topography,
- (22) and demographics. Because of this, use of the
- (23) definition of rural telephone company under
- (24) the Act reflects and captures the variability
- (25) of these markets better than any single test

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- (1) would.
- (2) Further, there is no compelling
- (3) reason to change this definition. Such a
- (4) change in eligibility likely would cause
- (5) certain rural carriers and the communities and
- (6) customers they serve to lose substantial
- (7) support. Considering the many comprehensive
- (8) reform measures currently before the FCC, this
- (9) is not the time to make radical changes to
- (10) universal service support eligibility rules.
- (11) In addition to considering major
- (12) changes to the current system of universal
- (13) service support, the FCC is considering
- (14) comprehensive reform to intercarrier
- (15) compensation. This proceeding will
- (16) disproportionately affect rural carriers. The
- (17) Joint Board must account for these shifts
- (18) before advocating any piecemeal changes to the
- (19) rural universal service fund eligibility and
- (20) calculation rules. The Joint Board should
- (21) take care not to exacerbate the volatile
- (22) regulatory environment already faced by rural
- (23) carriers.
- (24) Similarly, the Joint Board should
- (25) reject proposals to require carriers owned in

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- (1) a holding company structure to average their
- (2) costs holding-company wide or statewide. By
- (3) averaging costs across rural and non-rural
- (4) study areas, many study areas suddenly would
- (5) no longer qualify for high-cost loop support.
- (6) In other words, a rural study area could lose
- (7) its high-cost funding simply because it is
- (8) served by a telephone company that has
- (9) non-rural affiliates. Moreover, any averaging
- (10) approach to a cost-recovery mechanism creates
- (11) implicit subsidies and/or significant
- (12) increases in rates in rural areas. Either
- (13) result would be contrary to the goals of
- (14) section 254 of the Communications Act and work
- (15) to the detriment of rural consumers.
- (16) This proposed change also would
- (17) encourage holding companies that through their
- (18) operating subsidiaries serve both rural and
- (19) non-rural areas to sell off non-rural exchanges.
- (20) Such fractionalization of the industry would
- (21) destroy efficiencies that cannot be matched by
- (22) stand-alone telephone companies. The current
- (23) system fully captures the scale economies of
- (24) holding companies. These efficiencies lower
- (25) the company's reportable costs for universal

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- (1) service support purposes and reduce demand on
- (2) the high-cost fund.
- (3) Finally, ITTA advocates that rural
- (4) universal service continue to be calculated
- (5) using embedded costs and not a forward-looking
- (6) model. The embedded-cost mechanism is the
- (7) most precise method for determining network
- (8) cost. The differences between rural and
- (9) non-rural carriers make it problematic to apply
- (10) a forward-looking high-cost support mechanism
- (11) to rural carriers. The distortions caused by
- (12) a forward-looking cost models are far less in
- (13) the more homogenous non-rural areas. The
- (14) dislocations that have been demonstrated in
- (15) rural areas by using a forward-looking model
- (16) would produce disastrous decreases in funding
- (17) in rural areas.
- (18) There is good reason why the FCC has
- (19) twice declined to adopt the forward-looking
- (20) economic cost model for rural carriers. The
- (21) Joint Board should recommend that the FCC once
- (22) again reject the movement away from embedded
- (23) costs. Thank you.
- (24) COMMISSIONER ABERNATHY: Thank you
- (25) very much, Mr. Reynolds.

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- (1) And now we will hear from Joel Lubin,
 (2) who is with AT&T.
 (3) MR. LUBIN: Thank you very much.
 (4) Good afternoon. I want to thank
 (5) members of the Joint Board for putting the
 (6) hearing together and allowing me to
 (7) participate on the panel.
 (8) Before I address the questions asked
 (9) by the panel, I'd like to put some issues in
 (10) this proceeding in perspective. I'm going to
 (11) attempt to do that and summarize it in three
 (12) minutes, if I can.
 (13) Let me begin and talk about the issue
 (14) of rural versus non-rural in terms of the cost
 (15) methodology. As an individual who
 (16) participated in the Rural Task Force for about
 (17) 27 months, I learned a lot. And what I
 (18) learned at that point in time is that it's
 (19) extremely difficult to create a
 (20) forward-looking costing tool when you're
 (21) dealing with a thousand study areas, or 1200
 (22) or 1300 study areas. The record currently is
 (23) overwhelmed with information and data that
 (24) suggests the dilemma. I'm not saying it can't
 (25) be solved, but if it is going to be solved,

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- (1) you're going to have to spend a tremendous
 (2) amount of resources and a tremendous amount of
 (3) time. Up to this point in time, I have not
 (4) seen that.
 (5) Point number two, before we harmonize
 (6) the issues of costing between rural and
 (7) non-rural, from my point of view, I think there is
 (8) something even more important that requires
 (9) harmonization. And that is the patchwork
 (10) quilt of all forms of intercarrier
 (11) compensation methods. From my point of view,
 (12) I believe the intercarrier compensation issues
 (13) need to be addressed, have to be addressed,
 (14) and they can be addressed. I couple that with
 (15) universal service reform as well.
 (16) And the reason why I believe it is so
 (17) important is because, A, it's broken; and, B,
 (18) depending on how that gets changed, it will
 (19) affect how you answer the questions that are
 (20) before you today. It could, in fact,
 (21) eliminate the need for the questions to be
 (22) answered or, clearly, if they still need to be
 (23) answered, the way in which you solve it would
 (24) in my opinion be fundamentally different.
 (25) Second point is there's another

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- (1) docket - I guess it's the next panel on
 (2) eligible telecommunications carrier. There
 (3) again, I think you have to wait before you
 (4) answer some these questions until you see the
 (5) outcome of that docket. My company has put
 (6) forward the concept - and it's in the record
 (7) of other carriers or participants, as well -
 (8) of identifying a benchmark. That is to say,
 (9) over some level of subsidy that you obtain in
 (10) a particular geography, you conclude that you
 (11) only want to have one ETC. If you only have
 (12) one ETC, the question then becomes, is it
 (13) critical to have a TELRIC method for that one
 (14) ETC in that area if you're not going to have
 (15) multiple ETCs.
 (16) The other thing that I heard today
 (17) and is also in the record is this concept of
 (18) infrastructure. I think that code word for
 (19) infrastructure, as I understand it, is a code
 (20) word of we are in a circuit-switch world
 (21) moving to an IP world. And as we move from a
 (22) circuit-switch world to an IP world, I assume
 (23) incumbents want to ensure that the money that
 (24) they're getting in a circuit-based world will
 (25) still be potentially available in an IP world.

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- (1) I think that's a very legitimate question to
 (2) be looked at.
 (3) I also hear Billy Jack Gregg raise
 (4) the issue of where are we going in the future
 (5) with broadband. I think that's another
 (6) critical point that also has to get addressed.
 (7) And it also fits in with the whole
 (8) infrastructure question. And the reason why I
 (9) perceive it to be important is depending on
 (10) how this evolves, it's going to again help
 (11) begin to answer how these questions should be
 (12) answered and how one transitions the answers
 (13) to these questions in terms of operational
 (14) plans.
 (15) And I'll even just go one step
 (16) further. If we're talking about
 (17) infrastructure ultimately being supported by
 (18) universal service and we're ultimately talking
 (19) about a broadband pipe into the home, then the
 (20) question ultimately comes to how many
 (21) broadband types are you willing to subsidize
 (22) into the home. And so, I would hope we don't
 (23) take legacy solutions and try to superimpose
 (24) them in the new world. So, my bottom line is
 (25) I would hope that the Joint Board should

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- (1) proceed very cautiously with their
- (2) investigation, and it should certainly not
- (3) require devotion of resources, whether they be
- (4) state, federal, or industry resources, prior
- (5) to an order on intercarrier compensation and a
- (6) Commission order on ETC designation.
- (7) Thank you, and I'll be glad to
- (8) respond to questions.
- (9) COMMISSIONER ABERNATHY: Thank you
- (10) very much, Mr. Lubin. That was great.
- (11) Now, we'll hear from Mr. Weller with
- (12) Verizon.
- (13) MR. WELLER: Thank you, Madam
- (14) Chairman, and commissioners for the
- (15) opportunity to speak you today. My name is
- (16) Dennis Weller. As you just heard, I'm with
- (17) Verizon.
- (18) I think that we've all been reminded,
- (19) if we perhaps needed to be, by the recent
- (20) flap over accounting rules at USAC of the fact
- (21) that we're basically skating on the outer of
- (22) limit of what is possible for support in terms
- (23) of the overall size of the federal mechanisms
- (24) using any carrier contribution mechanisms and
- (25) not emphasize any - I think if we do long

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- (1) division by revenues or by connections or by
- (2) phone numbers, we still have a concern.
- (3) There's no magic wand that's going to solve
- (4) that funding dilemma, getting the same money
- (5) essentially to the same people.
- (6) That constraint being there, I think
- (7) we need to consider our main focus in the near
- (8) terms as controlling the size of the fund and
- (9) the measures that ensure incentives for
- (10) operating efficiently, that deal with costs of
- (11) duplication of supporting multiple networks,
- (12) and that also prevent us from expanding
- (13) without meaning to the entitlement that we
- (14) offer to consumers in rural areas in changing
- (15) the kinds of services that they can buy.
- (16) We've made four recommendations that deal
- (17) specifically with those concerns, and I'll
- (18) just list them quickly here.
- (19) First, we recommend that the FCC
- (20) should establish a rebuttable presumption that
- (21) there should be only one ETC in each rural
- (22) serving area.
- (23) Second, in areas where that
- (24) presumption's overcome and for whatever reason
- (25) they have more than one ETC, we need a second

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- (1) line of defense, another control mechanism.
- (2) We propose that that should be a primary line
- (3) approach that essentially de-couples the
- (4) carrier's - the customer's purchase decision
- (5) from how much subsidy they get, which I think
- (6) we need to do to avoid having somebody go
- (7) from, say, one wireline line to adding, say,
- (8) five wireless handsets. And so, \$20 in
- (9) subsidies turn into \$120 of subsidies.
- (10) The third measure that we would
- (11) propose is that at the outset of any new plan,
- (12) the support level should be based on the
- (13) incumbent carrier's actual expenditures during
- (14) the previous 12-month period rather than on
- (15) some level it's already cost us. However,
- (16) that should only be done once going forward.
- (17) And then that should be frozen and then
- (18) indexed so as to provide an incentive to all
- (19) ETCs in each area to operate efficiently.
- (20) And, finally, fourth, I think we need
- (21) to recognize that the larger carriers in rural
- (22) areas providing universal service have
- (23) characteristics in terms of density,
- (24) investment per line, portion of business
- (25) customers in the area, and so on, that really

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- (1) make them much more similar to the non-rural
- (2) carriers than they are to the smaller carriers
- (3) in rural areas.
- (4) And so, it makes more sense, we feel,
- (5) to consolidate study areas within each state
- (6) than on a consolidated basis that a carrier
- (7) that's serving more than 100,000 lines in a
- (8) given state ought to be treated the same way
- (9) as non-rural areas are.
- (10) Those are specific proposals. You'll
- (11) notice we provide incentives for efficiency
- (12) without going through what I think will be the
- (13) agony of developing a new cost model or
- (14) arguing about the inevitable errors in such a
- (15) mechanism.
- (16) I would also caution, given the
- (17) premise in which I started, in trying to
- (18) export the problems of the intercarrier
- (19) compensation world into this world where we're
- (20) already having enough problems dealing with
- (21) the difficulties we're facing here already.
- (22) And, finally, in conclusion, I'd like
- (23) to turn to the question that Billy Jack Gregg
- (24) asked, which is, what do we do about universal
- (25) service in a broadband age. And my answer to

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- (1) that is something completely different. I
- (2) don't think we should kid ourselves that the
- (3) near-term proposals that we're talking about
- (4) in these open proceedings are policy for the
- (5) ages or that they're going to survive more
- (6) than about, say, five years in the face of
- (7) changes I think we can all see coming.
- (8) I'm just going to list three of those
- (9) changes very quickly, and I invite your
- (10) questions during the remainder of the session.
- (11) First, we're all transitioning, we're
- (12) all building IP-based networks. So, as we do
- (13) that, we're going to exchange traffic, we're
- (14) all going to play by Internet rules, not by
- (15) the old circuit switch rules. Those new
- (16) networks and that change in the market is good
- (17) for the consumers. It's going to offer them
- (18) many more choices. But as a side effect, it's
- (19) going turn rural ILECs from net recipients of
- (20) access service to net payers of transit
- (21) service to interconnect with Internet
- (22) backbones.
- (23) Again, that's not a market solution
- (24) that we ought to try to change, but we need to
- (25) take account of it in considering what the

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- (1) requirements are going to be to meet our
- (2) universal service goals in the future.
- (3) Secondly, in terms of contribution,
- (4) simply put, we have a sector-specific approach
- (5) to contribution today, or certain
- (6) contributions from certain carriers. We're
- (7) one of only a handful of countries around the
- (8) world to try to do that. Most countries do it
- (9) out of general revenue. And by that, I don't
- (10) mean state plus interstate telcom revenue; I
- (11) mean the federal budget. A sector-specific
- (12) tax works if you can identify the sector.
- (13) Going forward as the telcom sector emerges
- (14) with a larger Internet, we're not going to be
- (15) able to do that and we're not going to tax the
- (16) larger Internet as whole. So, we have to work
- (17) through another funding source. That may be
- (18) painful but I think this may be like democracy
- (19) in that it's the worse solution except for all
- (20) the others.
- (21) And, finally, we have a certain
- (22) notion of how the universal service funding
- (23) mechanism works. Money goes into a fund,
- (24) comes out of a fund in terms of monthly
- (25) checks. The checks supported a fine, local

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- (1) service. And I think all of that framework is
- (2) going to be rethought for the future.
- (3) If I have a broadband connection to
- (4) the world, I may get my voice application from
- (5) anyone. It could be a VoIP provider in
- (6) Estonia. Unless we want to get into the
- (7) business of having USAC send checks to
- (8) Estonia, we probably need to rethink the
- (9) structure of that. We probably need to start
- (10) funding infrastructure more directly, perhaps
- (11) through up-front grants. One advantage of
- (12) that, I think, also is it decouples the
- (13) decision of what to support from the decision
- (14) about what to regulate. And I don't mean to
- (15) give you the answer to either of those, but I
- (16) suggest those decisions ought to be made
- (17) independently.
- (18) So, with that, I'll stop. And I
- (19) invite your questions. Thank you.
- (20) COMMISSIONER ABERNATHY: Thank you
- (21) very much, Mr. Weller.
- (22) And now, Mr. Dale Lehman from the
- (23) Alaska Pacific University. You probably came
- (24) the furthest. Thanks.
- (25) DR. LEHMAN: Probably flew the most

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- (1) hours, I think, yes.
- (2) Thank you for the opportunity to come
- (3) and participate in this panel. I don't
- (4) believe this panel exists because of the
- (5) theoretical differences between
- (6) forward-looking and embedded costs. I do
- (7) believe this panel exists because embedded
- (8) costs have a unique property in that they are
- (9) intimately tied to the actual costs of
- (10) providing universal service. And only
- (11) forward-looking costs provide the basis for
- (12) creating an illusion that somehow universal
- (13) service can be provided far more cheaply than
- (14) it is today. And I think that that illusion
- (15) is produced in three fundamentally flawed
- (16) ways, all of which have been provided to you
- (17) in various pieces of testimony.
- (18) One is this vision that somehow the
- (19) rural ILECs' costs are rapidly increasing. In
- (20) fact, they have pretty much matched inflation
- (21) on a cost-per-line basis. And I think the
- (22) best benchmark to compare that to is states'
- (23) own price cap proceedings in which 38 states,
- (24) their average X factor for productivity they
- (25) expect in a local exchange pretty much matches

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- (1) the inflation rate, which is what the
- (2) high-cost fund is also matching.
- (3) The growth in the high-cost funds,
- (4) which undeniably has been large in the last
- (5) five years, has been due primarily to a
- (6) restructuring from implicit to explicit
- (7) support, to some extent to the acquisition of
- (8) rural exchanges from larger carriers and
- (9) subsequent investment, to some extent through
- (10) the re-initializing of the cap that was in
- (11) place over the 1990s, and a very slight extent
- (12) to an increase in lines. But it's not that
- (13) the cost - the cost per line has not been
- (14) increasing dramatically. So, it's an illusion
- (15) to think that there's some waste that's
- (16) occurring suddenly in the last five years. It
- (17) was either there all along or it hasn't been
- (18) occurring.
- (19) The second is this perception, the
- (20) allegation of systematic waste and
- (21) inefficiency that goes on. And I think the
- (22) only evidence that's been provided of
- (23) systematic inefficiency concerns the issue of
- (24) the number of rural carriers and whether
- (25) massive consolidation would, in fact, be a

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- (1) good idea. And I suspect we may have some
- (2) more discussion of this, but I would just
- (3) point out that I don't think - I think the
- (4) cost savings are unproven and, in any case, I
- (5) think it is a very bad idea for rural areas to
- (6) think that you should be urging a massive
- (7) consolidation of rural telephone companies.
- (8) The third illusion of waste that goes
- (9) on is probably the most disturbing. And
- (10) that's this vision that technology is changing
- (11) and somehow it has dramatically reduced the
- (12) cost of providing universal service. I don't
- (13) think that comports with the facts on the
- (14) ground with the exception of possibly
- (15) switching. Loop costs have not experienced
- (16) that kind of technological progress. And
- (17) what's more troublesome is if you really
- (18) believe it has, we should be talking about a
- (19) different issue that's hardly been raised.
- (20) And that's that if carriers made
- (21) prudent investments in the past when
- (22) technology was different and now technology
- (23) has rendered the costs far lower than what
- (24) they already spent, they have under-recovered
- (25) those investments to this point in time, and

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- (1) we need to be talking about how to make them
- (2) whole in the sense of the prudent investments
- (3) they made in the past. And this is important
- (4) in a forward-looking sense because future
- (5) investment in rural areas depends on how you
- (6) treat the investments that were already made
- (7) in rural areas.
- (8) So, if you really believe that
- (9) technology has made the current technology
- (10) obsolete, we should be talking about how do we
- (11) ensure that carriers have an incentive going
- (12) forward to invest in the next generation of
- (13) technology, which will also be made obsolete
- (14) at some time in the future.
- (15) And, finally, I would say that I
- (16) think I agree with a couple of things that I
- (17) heard, that the choice of embedded costs and
- (18) forward-looking cost really shouldn't divert
- (19) you from far more important issues. And I
- (20) think intercarrier compensation, how to fund
- (21) competitive, eligible telecommunications
- (22) carriers, as well as the contribution that
- (23) comes in for USF are far more important and
- (24) far more worthy of your time than chasing
- (25) after a forward-looking cost standard.

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- (1) Thank you.
- (2) COMMISSIONER ABERNATHY: Thank you
- (3) very much, Dr. Lehman.
- (4) And, last but not least, Dr. Lee
- (5) Selwyn will be giving us a presentation from
- (6) Economics and Technology, Inc.
- (7) Thank you, Dr. Selwyn.
- (8) DR. SELWYN: Good afternoon,
- (9) commissioners. Thank you for the opportunity
- (10) to speak with you this afternoon. I will
- (11) summarize my written statement emphasizing a
- (12) couple of key points.
- (13) I think that the policy that has been
- (14) developed over the years, and you heard a lot
- (15) of it in the remarks so far this afternoon,
- (16) has been focused on rural carriers. I believe
- (17) that fundamentally universal service policy
- (18) has to be focused on consumers. And
- (19) consumers' interests may not coincide
- (20) precisely with the service providers that
- (21) serve these areas. Consumers' interest -
- (22) and, incidentally, consumer interests come
- (23) both with respect to rural consumers as well
- (24) as consumers in non-rural areas who are being
- (25) asked to contribute to the high-cost funding

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- (1) mechanism.
- (2) For the consumers who contribute,
- (3) obviously, as the total size of the fund
- (4) escalates and their surcharges continue to
- (5) rise, that's clearly a concern. But for
- (6) consumers in rural areas, if the size of the
- (7) fund continues to escalate at the rate at
- (8) which it has been escalating in recent years,
- (9) the political basis for continuing this
- (10) support mechanism could well erode. And the
- (11) very fact that some of the discussions that we
- (12) are having here today are taking place is
- (13) evidence of that. And that is not necessarily
- (14) in the interest of rural consumers who are
- (15) looking for ways to assure that service is
- (16) available in their community.
- (17) Second point is that there's been
- (18) some discussion about the effect of CETCs
- (19) entering in rural areas, getting
- (20) certification, and drawing funds from the
- (21) high-cost support mechanisms. Concerns are
- (22) expressed that if CETCs erode rural LEC
- (23) revenues, causing -- further escalating the
- (24) size of the fund and not allowing the rural
- (25) LECs to shed costs as rapidly as they might be

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- (1) shedding revenues.
- (2) Interestingly, these are not new
- (3) arguments. We've heard these arguments. I've
- (4) been involved in this field now for
- (5) 30-some-odd years, and we've heard these
- (6) arguments at every stage of the entry of
- (7) competition into almost every sector of the
- (8) telecom industry. And this is simply the
- (9) latest incarnation.
- (10) If we have a national commitment to
- (11) competition, I don't think it's appropriate to
- (12) carve out certain segments of the country and
- (13) simply declare competition as nonfeasible and
- (14) not to be supported. If we subsidize
- (15) incumbents and do not subsidize competitors
- (16) serving the same types of customers in the
- (17) same areas, we create very perverse
- (18) incentives. We deny customers in those
- (19) communities access potentially to more
- (20) efficient, lower cost, and perhaps more
- (21) functional -- more highly functional
- (22) technologies and alternate services. It's
- (23) hard for a competitor to come in and compete
- (24) with a subsidized incumbent. It's hard enough
- (25) for a competitor to compete with an incumbent.

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- (1) If the incumbent is subsidized, it may make
- (2) entry almost impossible.
- (3) Competition at a certain level is
- (4) going to happen as we move more toward
- (5) broadband. Intermodal competition that the
- (6) Commission has expressed such interest in in
- (7) recent years in other fora, it will come to
- (8) rural areas. And rather than bury our heads
- (9) in the sand and assume it won't have any
- (10) effect as long as the CETCs as are excluded
- (11) from the subsidy mechanism or CLECs are not
- (12) certified and therefore do not receive
- (13) subsidy, there will continue to be revenue
- (14) erosion.
- (15) With respect to the issue of embedded
- (16) versus forward-looking costs, years ago all
- (17) local exchange carriers were regulated on the
- (18) basis of embedded cost under a system
- (19) regulation known as rate-of-return regulation.
- (20) At that time, the carriers would submit
- (21) extensive rate cases, sometimes 15 or 20 or 25
- (22) witnesses, extensive financial and other data.
- (23) Commissions would review this, would determine
- (24) the legitimacy of investments, legitimacy of
- (25) various operating expenses, would conduct

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- (1) audits and reach conclusions as to the overall
- (2) revenue requirement. They would consider all
- (3) sources of revenue that were available to the
- (4) LEC.
- (5) When we speak of embedded costs in
- (6) the context of rural carriers -- and the
- (7) notion that these somehow are actual costs, I
- (8) think raises some serious question. Nobody is
- (9) really looking at these costs. They may be --
- (10) they may not have increased in inefficiency,
- (11) but they certainly have an incentive to
- (12) continue to escalate spending and escalate
- (13) their operating costs if they can be assured
- (14) reimbursement.
- (15) It seems to me what we need to move
- (16) to is a system that will eliminate perverse
- (17) incentives, that will eliminate incentives of
- (18) larger carriers to sell off smaller exchanges
- (19) because they have been able to access more
- (20) high-cost support incentives that would favor
- (21) incumbent technology and incumbent carriers
- (22) over entrance. And, as a general matter,
- (23) doing these things will make -- will really
- (24) satisfy and achieve the goals of the Telecom
- (25) Act, which is to give to rural communities

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- (1) access to the same and equivalent services
- (2) that are available in urban areas and at
- (3) prices that ultimately will come to be
- (4) comparable to those available in non-rural
- (5) areas.
- (6) Thank you. And I'd be happy to
- (7) respond to any questions.
- (8) COMMISSIONER ABERNATHY: I want to
- (9) thank all our panelists. You did exactly what
- (10) we asked you, to give us a high-level summary,
- (11) raise a lot of questions.
- (12) So, I think what I'll do is for the
- (13) first round we'll start to my right. We'll
- (14) start out with Commissioner Jaber, and then on
- (15) down to Commissioner Martin. And because
- (16) we've got enough time, I think each
- (17) commissioner can go with two questions. If we
- (18) still have time after that, we'll do another
- (19) run.
- (20) COMMISSIONER JABER: Let me seek your
- (21) guidance, Madam Chairman. I have a question
- (22) that I would like to pose to any panelist who
- (23) wants to comment on it. And then I have a
- (24) second specific question.
- (25) The first one is as I said in the

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- (1) Introduction. I want to focus a little bit on
- (2) the definition of the rural telephone company.
- (3) And I heard panelists specifically address
- (4) that.
- (5) Mr. Colt, you took a specific
- (6) position on it. And my question to you, and
- (7) then generally to the panelists, is I think
- (8) that there's recognition that some carriers
- (9) are receiving support from the program having
- (10) met the definition of rural telecommunications
- (11) carrier company, but yet serve in a non-rural
- (12) area. In my state, in particular, I know of
- (13) one that is in the Disney area. Disney is not
- (14) rural in Florida. I pose that to anyone who
- (15) wants to comment on it.
- (16) And then, Dr. Lehman, my question to
- (17) you is one that comes from confusion and I
- (18) apologize for that. I'm not sure if you were
- (19) advocating that we go back and make companies
- (20) whole by doing rate cases. When you
- (21) referenced, you said that perhaps it's a
- (22) question of these incumbents who have not
- (23) fully recovered the cost of infrastructure.
- (24) All I could think of was, are you advocating
- (25) for rate cases?

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- (1) DR. LEHMAN: No. I think the rate
- (2) case is an inefficient way to go about that.
- (3) But I think the point is if the money was
- (4) already spent and it was spent when newer
- (5) technology that is presumably much cheaper -
- (6) which I actually don't accept as far as loop
- (7) access goes - but if that's your premise,
- (8) then it's much cheaper, to provide access to
- (9) loop facilities. The money was well spent in
- (10) the past, but it hasn't yet been recovered.
- (11) You can't just sort of pull out and say, oh,
- (12) well, the cost has gone down so now you get
- (13) half of what you got before. Because the next
- (14) round, nobody is going to invest in the newest
- (15) technology without a much more accelerated
- (16) fashion of recovery.
- (17) In some sense, it means the
- (18) depreciation was inadequate in the past
- (19) because we're now saying the economic reality
- (20) is these facilities really don't have much of
- (21) a life left or don't have much value left.
- (22) But you're stuck with them on the books
- (23) because the world has changed, not unlike
- (24) stranded costs in electric, which I know you
- (25) have a lot of experience dealing with. And

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- (1) generally the principle has been accepted that
- (2) stranded costs are an issue that needs to be
- (3) dealt with. I think there is a huge stranded
- (4) cost issue in telecommunications if you
- (5) believe the premise that costs have
- (6) dramatically come down.
- (7) COMMISSIONER ABERNATHY: Go ahead,
- (8) Dr. Selwyn.
- (9) DR. SELWYN: We don't know that those
- (10) costs haven't been recovered because we don't
- (11) have any traditional rate of return analysis
- (12) of revenues and costs. What we have is a
- (13) funding mechanism that is sort of cost driven,
- (14) but is not really focusing on what we might
- (15) term a traditional revenue requirement.
- (16) What we do know is that when
- (17) exchanges are being sold off, rural exchanges
- (18) are being sold off, the prices that the buyer
- (19) is paying for them are multiples of book
- (20) value, which would certainly give an
- (21) indication that buyer expects not just to
- (22) recover the book value of that investment, the
- (23) embedded cost, but will in excess of the book
- (24) value.
- (25) So, I think in point of fact, if

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- (1) you're going to continue to rely on embedded
- (2) costs, you must make the very kind of
- (3) determination that Dr. Lehman has suggested is
- (4) inefficient. That is, you must make a
- (5) determination as to whether or not that
- (6) subsidy is required, whether or not all
- (7) sources of revenue – some of which may be
- (8) below the line and non-regulated but
- (9) nevertheless flow to that infrastructure –
- (10) are, in fact, not fully sufficient to recover
- (11) the investment. And I don't believe there's
- (12) ever been a demonstration to the contrary.
- (13) COMMISSIONER JABER: And the
- (14) definition issue and whatever follows.
- (15) MR. COIT: Can I speak to that first,
- (16) please?
- (17) My name is Richard Coit. With
- (18) respect to the rural definition issue, and you
- (19) mentioned the fact that we had taken a
- (20) position on that. And in our comments, we
- (21) have taken the position that – with respect
- (22) to determining distribution of support that
- (23) the rural definition that's contained in the
- (24) federal Act should be used. It would seem
- (25) that that – I guess you can raise an argument

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- (1) as to, you know, what the legal ramifications
- (2) might be to try to pursue some other
- (3) definition.
- (4) But the fact of the matter is that
- (5) the law today defines rural telephone
- (6) companies differently under the ETC
- (7) designation provisions. And it would seem to
- (8) us that you have to maintain some consistency
- (9) with that because of the public interest
- (10) standard that is there. That is there for the
- (11) purposes of evaluating whether a carrier
- (12) should receive federal universal service
- (13) funding and through designation as an ETC.
- (14) One of the concerns that we have
- (15) with respect to the way things are working
- (16) today, is it appears to us that there are
- (17) competitive carriers that if you looked at them
- (18) in total, you know, certainly would not be
- (19) receiving rural support if you look at the rural
- (20) definition. They're receiving rural support
- (21) simply because they're providing service in a
- (22) rural area. And that accounts for – I think we
- (23) noted in our comments that it appears that that
- (24) may account for about 25 percent of the support
- (25) that's going out to competitive carriers. And

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- (1) that's a concern that we have that we do believe
- (2) should be addressed.
- (3) MR. WELLER: Commissioner, there's a
- (4) famous article in economics called the
- (5) Disneyland Dilemma and maybe that was
- (6) anticipating your question. I don't know.
- (7) Let me just mention a couple facts in framing
- (8) the answer to your question. First of all, a
- (9) large number of – as you know, mid-sized
- (10) carriers have been growing a lot recently.
- (11) And a lot of the lines that we're talking
- (12) about here are those that they have acquired
- (13) from larger carriers. So, there are already
- (14) constraints on the support that they receive.
- (15) So, for a lot of – a the large portion of the
- (16) ones we're talking about, this may not be that
- (17) great of a change to treat them as non-rural
- (18) because respectively they're capped at that
- (19) level already.
- (20) There are also some safety catches
- (21) already built into the system, the
- (22) safety-valve system. And it probably makes
- (23) sense to continue that sort of cap for
- (24) extraordinary circumstances where it's really
- (25) necessary to make large investments in a

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- (1) particular area. Having said that, though, I
- (2) think if you look across the larger
- (3) companies – incidentally, my company would be
- (4) affected by this. I think our estimate is it
- (5) would probably cost us about \$7 million per
- (6) year in support to do what I've proposed. But
- (7) we need to look at ways to preserve the
- (8) support so it's directed to where it's really
- (9) much needed.
- (10) I think if we're looking at carriers
- (11) who, either because of their size have
- (12) economies of scale similar to larger companies
- (13) in terms of large portions of their,
- (14) essentially, overhead parts of their
- (15) operations or else because of the areas that
- (16) they serve in terms of density loop investment
- (17) and so on, aren't that different an operation
- (18) than non-rural companies, then we do, I think,
- (19) have to start to think about the wisdom of
- (20) treating them in the same category as much
- (21) smaller companies.
- (22) And as far as the definition is
- (23) concerned, again, I'm not the attorney here.
- (24) This could be my revenge on lawyers trying to
- (25) do economics. My understanding is that the

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- (1) definitional differences set forth in the Act
 (2) is with respect to certification of the ETCs.
 (3) And the Commission is not obligated to use
 (4) that as a dividing line in terms of the way
 (5) funding is structured and indeed only arrived
 (6) at that after several years of deliberations
 (7) as a matter of convenience. So, they can
 (8) depart from that if the Joint Board of
 (9) commissioners finds that suits what they need
 (10) to do.
 (11) MR. GARNETT: Just to follow on
 (12) Mr. Weller's point, the Act in section 254
 (13) does not talk about rural carriers. It talks
 (14) about consumers in rural high-cost areas.
 (15) This is a point actually made back in course
 (16) of the RTF proceeding by the Vermont and Maine
 (17) Commissions, and the Commission noted that in
 (18) the order itself in a footnote buried in the
 (19) back of the item, but I do remember it.
 (20) I think the critical thing here is
 (21) that whatever support mechanism we have has to
 (22) target support to rural areas, not to rural
 (23) carriers or to carriers based on whether they
 (24) might be big or small. So, your example of
 (25) Sprint in Florida is a good one but -

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- (1) COMMISSIONER JABER: Smart City.
 (2) MR. GARNETT: I'm sorry?
 (3) COMMISSIONER JABER: Just for the
 (4) record, it's Smart City Telecom.
 (5) MR. GARNETT: Okay. Well, the other
 (6) example is Sprint has 2 million lines in
 (7) Florida. That is the one I thought you were
 (8) thinking of. But in any case it could be that
 (9) Sprint does serve some high-cost areas or the
 (10) company you were talking about does serve some
 (11) high-cost areas. And whatever support
 (12) mechanism we have in place should target
 (13) support to those high-cost areas.
 (14) One of the problems with the current
 (15) system is we have this problem of averaging.
 (16) So, under the current system if you have a
 (17) study area that has 2 million lines in it and
 (18) there are high-cost and low-cost areas in that
 (19) study area, you're not going to get support
 (20) under most cases. And the same thing is true
 (21) under the non-rural mechanism where you average
 (22) costs at the state level.
 (23) We think ultimately the better system
 (24) is to get rid of the statewide averaging and
 (25) study area averaging and target support to

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- (1) wire centers or to a specific, small
 (2) geographic region. And that, we think, is
 (3) more consistent with requirement of the Act.
 (4) COMMISSIONER ABERNATHY: Why don't we
 (5) go ahead and move on to Billy Jack.
 (6) CONSUMER ADVOCATE GREGG: It's hard
 (7) to know where to start. There are so many
 (8) issues and so many questions. But I guess we
 (9) may as well start with this, I'm sure you all
 (10) saw this on the cover of the USA Today
 (11) yesterday, the story about universal service
 (12) paid out to rural companies.
 (13) The allegations in the story and the
 (14) anecdotes that were given is that there are a
 (15) number of small rural companies that were
 (16) earning well into the 20 percent range, paying
 (17) out large dividends and large salaries to
 (18) their employees, that nevertheless pulled down
 (19) large amounts of federal universal service
 (20) funds.
 (21) There are currently state universal
 (22) service funds that take a last look after the
 (23) mechanism has run before they determine
 (24) whether any additional funds or support should
 (25) be paid out. They look at a bottom line,

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- (1) whether that's earnings or a certain specified
 (2) amount of revenues over the earnings. The
 (3) federal universal service fund for rurals does
 (4) not look at costs. And, in fact, local
 (5) switching does not even - I'm sorry, looks at
 (6) cost. Local switching does not even look at
 (7) cost in paying out support.
 (8) Has the time come for the federal
 (9) universe service support mechanisms to take a
 (10) last look, either based on total revenues
 (11) produced by the loop - and we considered
 (12) unseparated loop costs - or to look at the
 (13) bottom line return in determining whether
 (14) additional federal universal service funds
 (15) should be paid out? And I'll just put that
 (16) open to any of the panelists.
 (17) MR. WELLER: I guess we need a
 (18) volunteer. I'll step forward.
 (19) I think this is sort of a fundamental
 (20) question we have to ask ourselves about
 (21) philosophy here before we get into specific
 (22) details, because there are all sorts of ways
 (23) that we can go back to more regularly
 (24) approaches. I've already mentioned, you know,
 (25) constructing cost models and tried to

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- (1) prescribe costs. We can also sort of -- we
- (2) can go back and audit people trying to look
- (3) for bad actors, or we can suck back into
- (4) regulation, processes that are starting to
- (5) step away from it.
- (6) I think the answer to your earlier
- (7) question about what do we do in a broadband
- (8) age is that we don't get more with regulatory,
- (9) we get less from regulatory. As I said
- (10) earlier, I think we need to find ways to have
- (11) universal service be efficient, but we need to
- (12) be clever in thinking of ways to do that that
- (13) don't rely on more regulation because we
- (14) probably want to decouple universal service
- (15) from regulation. And the amount of support
- (16) that's needed in area may be separate from the
- (17) amount of regulation that's needed in an area.
- (18) So, I would be very concerned about a
- (19) mechanism that would require us to go back and
- (20) do essentially a rate case on every company at
- (21) the end of every year, even though I think
- (22) that's well intentioned.
- (23) I think something that sets incentives
- (24) in the structure of the payouts in the
- (25) manner that we've had good results from, is

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- (1) incentive regulation both at the federal level
- (2) and the state level in the last 15 years is a
- (3) simpler, less contentious, and ultimately more
- (4) productive way of going about things.
- (5) CONSUMER ADVOCATE GREGG: Dr. Selwyn?
- (6) DR. SELWYN: Thank you. You know,
- (7) the proponents of embedded cost as the basis
- (8) for support seem to want to have it both ways.
- (9) They want to retain the trappings of a
- (10) regulatory burden while not actually -- in
- (11) terms of the basis for funding without
- (12) actually accepting the mechanism of regulation
- (13) to determine that the funding is reasonable.
- (14) What we have right now is -- and I
- (15) think there's very strong evidence of this --
- (16) is that carriers in rural areas who are
- (17) getting high-cost support are also able to
- (18) exploit -- and I don't mean that in a
- (19) pejorative sense. They're able to exploit
- (20) their infrastructure to develop new revenue
- (21) sources from broadband services, DSL, other
- (22) things that are capable of producing revenues
- (23) sufficient to defray all their costs. And in
- (24) those circumstances it seems to me that it's
- (25) entirely unreasonable for anyone outside of

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- (1) those communities to also be asked to provide
- (2) subsidy.
- (3) As I mentioned, there is strong
- (4) evidence that these properties are valued at
- (5) well in excess of embedded costs, which means
- (6) that people buying them -- smaller companies,
- (7) smaller midsize companies that are buying
- (8) rural exchanges are prepared to -- are willing
- (9) to in effect capitalize future excess earnings
- (10) by paying premium prices over the cost of
- (11) support for those assets.
- (12) That in itself is evidence of the
- (13) sufficiency of the existing revenues from all
- (14) sources, because that's what the buyer looks
- (15) to. The buyer does not limit the scope of a
- (16) decision to regulated revenue. The buyer
- (17) looks at all revenues. At an aggregate level,
- (18) the holding companies that own a lot of
- (19) exchanges that are receiving high-cost support
- (20) are similarly being traded. Their equities
- (21) are being traded well in excess of book
- (22) values. So, their investors, their public
- (23) stockholders, are making a similar kind of
- (24) choices.
- (25) We don't -- in a sense -- maybe I

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- (1) would be forced to agree that maybe we don't
- (2) need to do general rate cases on each of these
- (3) companies because the evidence is overwhelming
- (4) that their revenues are sufficient without
- (5) support. But if a company wants support, it
- (6) seems to me it has to be asked and made to
- (7) make a showing that that support is required.
- (8) MR. GARNETT: In response to your
- (9) question, we don't think that, you know, the
- (10) commissioners should get in the business of
- (11) punishing companies for making money. But at
- (12) the same time I think that we don't think it's
- (13) appropriate for universal service to be one of
- (14) an ETC's best profit centers.
- (15) And under the current system, under
- (16) embedded cost system, and also under the
- (17) forward-looking system, carriers are
- (18) guaranteed a rate of return under the
- (19) high-cost universal service mechanisms. And
- (20) that rate of turn, by the way, was
- (21) determined -- was based on the then -- the
- (22) cost of capital for Bell operating companies
- (23) 16 years ago, 11.25 percent.
- (24) I think that USAC does a pretty good
- (25) job of paying out high-cost subsidies to the

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- (1) carriers that receive them. I'm guessing that
- (2) they always get their check from USAC
- (3) eventually. There's no risk associated with
- (4) universal service. So, let's get risk-related
- (5) profits out of the universal service
- (6) mechanisms.
- (7) One thing that CTIA has proposed
- (8) among a number of fixes to the current system
- (9) is to basically reduce that 11.25 percent to a
- (10) lower number that would reflect -- that
- (11) basically gets that risk-related profit out of
- (12) the universal service mechanisms. Ultimately,
- (13) we think that profits should come from
- (14) consumers, not from the universal service
- (15) mechanism.
- (16) COMMISSIONER NELSON: Mr. Reynolds.
- (17) MR. REYNOLDS: Jeff Reynolds with
- (18) ITTA.
- (19) Some of this rate-of-return-bashing,
- (20) I'll call it, is it's a little bit misplaced.
- (21) First of all, I'd like to correct the notion
- (22) that there's a guaranteed return that comes
- (23) out of rate-of-return regulation.
- (24) Particularly in the federal rules, it's the
- (25) opportunity to earn 11 and a quarter. And

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- (1) that just doesn't come cruising in there
- (2) easily.
- (3) Also, relative to the cost recovery
- (4) mechanism of high-cost universal service,
- (5) while I agree with Dr. Selwyn that in
- (6) evaluating acquisition companies certainly
- (7) look at all revenue streams that are
- (8) available. There's considerable time between
- (9) when deals are struck and when those deals are
- (10) consummated. Particularly for ILECs, there's
- (11) a considerable process where that's vetted
- (12) through both the state and the federal
- (13) regulatory agencies.
- (14) So, while there's obviously -- you
- (15) know, what this historic revenue streams have
- (16) been as a practical matter when these
- (17) companies acquire rural exchanges, oftentimes
- (18) there's considerable investment, considerable
- (19) risk that goes along with that. You don't get
- (20) paid back instantaneously. You know, the
- (21) current embedded cost, rural high-cost
- (22) universal service mechanism works on a lag
- (23) basis. So, you're getting a return on your
- (24) unseparated loop costs, but it doesn't all
- (25) come back.

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- (1) And, in fact, as you lose lines to
- (2) competition over time, you're undergoing
- (3) considerable risk. In a way an embedded cost
- (4) mechanism -- and without even the necessity
- (5) for a rate case, it's self-correcting in the
- (6) sense that -- to the extent that the reporting
- (7) mechanisms are in place there, there's a lot
- (8) of accountability, and it can be measured and
- (9) monitored. And as Dennis suggested --
- (10) although you don't necessarily want to get
- (11) that business -- if there are abuses and bad
- (12) actors out there, there's a way to get at them
- (13) right now. So, I don't -- I find a lot of the
- (14) rhetoric on this unfounded.
- (15) DR. LEHMAN: This is Dale Lehman.
- (16) Returning to your pointing to the
- (17) newspaper, it seems to me there's three
- (18) courses of action to deal with with issues of
- (19) abuse.
- (20) One of them is, as you suggest, not
- (21) looking at the earnings of the company. But I
- (22) share Mr. Weller's concerns that we're headed
- (23) down a road of much more regulation and really
- (24) full blown rate cases for every single rural
- (25) company.

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- (1) A second course of action is better
- (2) auditing. Auditing is not perfect, but
- (3) certainly can be done and more resources put
- (4) into auditing can catch the, quote, bad
- (5) actors.
- (6) The third course is the one that Mr.
- (7) Weller suggested, and I think has a lot of
- (8) appeal, which is just to have better
- (9) incentives on the cost side and a price cap
- (10) mechanism which essentially you have on the
- (11) overall fund today, having frozen the size of
- (12) it. You know, it has a lot of appeal.
- (13) The only thing I caution you is to be
- (14) careful what you ask for because when you put
- (15) strong cost-reducing incentives in place, that
- (16) means strong cost-reducing incentives. And
- (17) some of those might be in terms of not rolling
- (18) out broadband as quickly because despite the
- (19) ability to leverage the existing
- (20) infrastructure and make broadband revenues,
- (21) many companies have such low take rates on
- (22) broadband currently that it is not a
- (23) profitable investment. And they will think
- (24) harder about making those investments in the
- (25) future.

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- (1) So, before you go down the road of
- (2) throwing out auditing and saying what you want
- (3) is stronger incentives, at least make sure
- (4) that you thought through that you really want
- (5) cost reduction to be first on the mind of all
- (6) the companies under universal service funding.
- (7) DR. SELWYN: Lee Selwyn.
- (8) I don't think this is an issue of bad
- (9) actors and good actors. Clearly, you can
- (10) always find some bad actors, and that's what
- (11) the USA Today article has identified.
- (12) But we have a system that does not
- (13) encourage efficiency, that rewards
- (14) inefficiency. And even without impugning the
- (15) integrity or honesty of anybody, the fact is
- (16) that when a company is confronted with an
- (17) opportunity to have its costs recovered, to be
- (18) made whole, irrespective of the way it runs
- (19) its business, that is an absolute, guaranteed
- (20) ticket to inefficient operations. And we try
- (21) to address that to the larger ILECs with price
- (22) cap regulation. And unless we are prepared to
- (23) do similar types of monitoring as we did in
- (24) the pre-price cap days under rate-of-return
- (25) regulation for these smaller companies, these

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- (1) inefficiencies will persist. And it's not an
- (2) issue of bad actors. It will persist simply
- (3) because the institution encourages it.
- (4) CONSUMER ADVOCATE GREGG: My second
- (5) question deals with the role of the states.
- (6) Under the current universal service mechanisms
- (7) of the federal government, if a rural company
- (8) qualifies for support, it receives that
- (9) support, irrespective of what the state does
- (10) with rates or with its state universal service
- (11) fund or whether it has a state universal
- (12) service fund. The Tenth Circuit Court of
- (13) Appeals directed the FCC and the Joint Board
- (14) to develop a support system for non-rurals that
- (15) contains some sort of inducements to the
- (16) states to help support universal service.
- (17) Indeed, the Tenth Circuit said that it had to
- (18) be a joint effort of states and the federal
- (19) government.
- (20) Do you believe that it would be
- (21) appropriate to require states to do certain
- (22) actions first in terms of rates, in terms of
- (23) state-supported state universal fund and to
- (24) maximize those state resources prior to
- (25) calling on consumers in other states to help

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- (1) support their rates within their state?
- (2) And I'll ask Mr. Quoit first and then
- (3) Mr. Gamett.
- (4) MR. COIT: Thank you. We definitely
- (5) believe that something needs to be done along
- (6) the lines of encouraging states to take a
- (7) share of the universal service burden. Over
- (8) the last several years we have seen in
- (9) non-rural areas, I think, two or three
- (10) additional ETCs designated. In the rural
- (11) areas of South Dakota - and not necessarily
- (12) all of the rural areas of South Dakota, but we
- (13) have at this time the incumbent has an ETC;
- (14) one wireless carrier has an ETC; another
- (15) wireless carrier that - actually, two other
- (16) wireless carriers have applied, and it
- (17) certainly appears that the second wireless
- (18) carrier that applied has a fair shot at
- (19) getting ETC status.
- (20) And I look at that and it seems to me
- (21) that the reason it is happening is that our
- (22) state Commission has absolutely no skin in the
- (23) game. They're looking at it as a way of
- (24) improving wireless coverage, period. And it's
- (25) made really without regard to, I think, the

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- (1) real facts of some of these - the reality of
- (2) the low densities in some of these areas.
- (3) Golden West Telecom cooperative is
- (4) the largest cooperative in the state of South
- (5) Dakota. It covers about 25,000 square miles.
- (6) If you look at that and you consider that area
- (7) to be a state, it would be the 41st largest
- (8) state in the country. And it serves only 2.1
- (9) access lines per route mile of facility
- (10) throughout that entire area on average. Does
- (11) it make sense to be designating two, three,
- (12) four ETCs within that area? We can talk about
- (13) inefficiencies and waste so forth, but that
- (14) whole issue of portability and the number of
- (15) ETCs that are designated, the states have to
- (16) be accountable. And I don't think today they
- (17) are.
- (18) You mentioned the benchmark. It
- (19) seems to me that that is a critical element
- (20) going forward to making sure that, you know,
- (21) there isn't some abuse. You know, should
- (22) companies be getting a bunch of USF if their
- (23) local service rates are 6, 7, 8, \$9 a month,
- (24) no. I don't believe they should, and I think
- (25) there's a reason for those benchmarks. And

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- (1) that is to not necessarily to require
 (2) companies to move their rate up to a
 (3) particular level, but make sure that if they
 (4) don't that the modest support they get is
 (5) going to be impacted by that.
 (6) MR. GARNETT: We definitely think
 (7) that states have an important role to play,
 (8) and the Tenth Circuit has said they do. And
 (9) in the non-rural proceeding that's certainly
 (10) something you looked at. And in our comments
 (11) one thing that we noted is that in many cases
 (12) you have a situation where rates in rural
 (13) areas are actually lower than they are often
 (14) in urban areas. Sprint went into considerable
 (15) detail on this issue in its comments. SBC
 (16) talked about this issue a couple of
 (17) proceedings ago, in the non-rural proceeding.
 (18) One idea that we talked about which
 (19) ultimately didn't make it into our comments
 (20) but I think is actually kind of an interesting
 (21) idea is to develop an affordable nationwide
 (22) rate and support a percentage of costs that
 (23) are above that benchmark, use that as your
 (24) benchmark. And that way you can encourage
 (25) states to do more to increase rates for rural

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- (1) ILECs and for ILECs generally and to get us to
 (2) a situation where rural ILECs are getting more
 (3) than 17, 18, 19, 20 percent of their revenues
 (4) from customers and away from a situation right
 (5) now where you have carriers getting 80
 (6) percent, in some cases 90 percent of their
 (7) revenues from a combination of universal
 (8) service and access.
 (9) COMMISSIONER NELSON: Let me pick up
 (10) on something Dr. Selwyn has mentioned. And
 (11) that is that no one is looking at the cost and
 (12) that there is certainly no incentive to
 (13) control cost under the system.
 (14) And I'd like to ask either Dr. Lehman
 (15) or Mr. Reynolds. I think Mr. Weller has a
 (16) proposal which responds to that point. And
 (17) that is to look at the indexing of actual
 (18) expenditures, looking back at the actual loop
 (19) cost over a 12-month period and indexing them.
 (20) Would this be a suitable way to look at
 (21) controlling costs for rural telcos and should
 (22) this be applied to all ETCs in the area?
 (23) Either Dr. Lehman or Mr. Reynolds.
 (24) DR. LEHMAN: This is Dale Lehman. As
 (25) I was trying to indicate, I think one of the

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- (1) real appeals of this proposal is that it does
 (2) give cost-reducing incentives. But whether or
 (3) not that's what you want, I mean, we all think
 (4) about the good kinds of cost-reducing
 (5) incentives, which are to avoid waste and
 (6) inefficiency. Some of the cost reduction
 (7) might take the form of not rolling out new
 (8) services well in advance of demand, which many
 (9) rural carriers have done. So, I'm not
 (10) entirely sure that maximizing cost reducing
 (11) incentives is always a wise thing to do.
 (12) But on the face of it, I think that
 (13) does address a lot of the concerns. And for
 (14) all practical purposes, we are doing that
 (15) today except not on a carrier level. In terms
 (16) of the whole fund, it is indexed to inflation,
 (17) and the fund is not allowed to grow - you
 (18) know, we re-initialize the cap, but it's still
 (19) capped.
 (20) CONSUMER ADVOCATE GREGG: Should this
 (21) be applied to all ETCs in the area, though?
 (22) DR. LEHMAN: I'll deal with that in
 (23) the second panel, because I don't believe this
 (24) is the basis for the competitive ETCs that are
 (25) sitting here today.

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- (1) CONSUMER ADVOCATE GREGG: Mr.
 (2) Reynolds?
 (3) MR. REYNOLDS: I think one of the
 (4) things with - I guess I regard the indexing
 (5) mechanism as unnecessary just from the
 (6) standpoint that the embedded cost mechanism
 (7) that's out there right now is self-correcting.
 (8) I want to circle back to something
 (9) that Mr. Weller said relative to the
 (10) efficiencies that come with holding companies.
 (11) Most of the operating costs associated with
 (12) high-cost loops exist at the operating company
 (13) entity. So, when you've got multiple entities
 (14) within a state, the efficiencies are not
 (15) happening in these non-contiguous areas. I
 (16) think the efficiencies that happen in
 (17) corporate operation expense exists back at the
 (18) holding company level. That flows down
 (19) through the mechanism, so in that sense it's
 (20) almost self-correcting.
 (21) It would probably be interesting to
 (22) look and see over time how the rural companies
 (23) on an embedded cost methodology have
 (24) performed. I know that just from dealing with
 (25) companies such as CenturyTel and AITel that

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- (1) they're not even hitting the corporate
- (2) operating expense limits right now. So, that
- (3) cap is, to a certain extent, meaningless and
- (4) those efficiencies are flowing through. So, I
- (5) think that going to an indexing approach is
- (6) unnecessary at this point in time.
- (7) CONSUMER ADVOCATE GREGG: Joel?
- (8) MR. LUBIN: I wanted to clarify a
- (9) couple points and also ask Dennis a question
- (10) in terms of his indexing approach, because
- (11) AT&T also put forward an indexing. And I
- (12) don't know if it's the same, so I'm going to
- (13) describe what we talked about and so how
- (14) parties react.
- (15) But for me the dilemma here is that
- (16) the incumbent rural telcos are rate-of-return
- (17) regulated. And when you are rate-of-return
- (18) regulated and then you have, let's say, 1300
- (19) study areas, trying to figure out either a
- (20) price-cap mechanism or a forward-looking
- (21) costing tool for the diversity and richness of
- (22) the 1300 rural study areas, is a very
- (23) complicated process, whether it's a model or
- (24) whether it's a price cap. And so, right now
- (25) the way in which they're regulated is rate of

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- (1) return.
- (2) Now, it's true that we have a cap on
- (3) the high-cost fund, but that cap is only on
- (4) rural telephone company incumbents and it's
- (5) indexed in aggregate. The CLECs who come in,
- (6) be it wireless or wired, if they're a CETC,
- (7) however much money they get is above and
- (8) beyond the cap, the fund.
- (9) So, my question to Dennis is what
- (10) AT&T put forward was the concept of once a the
- (11) CETC shows up, be it wired or wireless you, in
- (12) effect, look at what the incumbent per line is
- (13) getting. The incumbent going forward, if they
- (14) lose a lot of lines such that their subsidy
- (15) per line could skyrocket because they're
- (16) rate-of-return regulated, their costs really
- (17) aren't shed, but if, in my extreme, let's say
- (18) they lose half their lines just to make a
- (19) point. The subsidy per line could be more
- (20) than doubled. And we said, that doesn't seem
- (21) to be fair if the incumbent, because a CETC
- (22) wins half the lines and doubles the subsidy
- (23) per line, that the new entrant should get the
- (24) same amount.
- (25) However, it did make sense that if a

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- (1) CETC entered, be it wireless or wired, they
- (2) should get the same amount on day one, but not
- (3) the inflated amount if you're rate-of-return
- (4) regulated and if the incumbent's losing a lot
- (5) of lines. However, there was a balancing act.
- (6) The balancing act is if the incumbent is going
- (7) to be investing aggressively for whatever
- (8) reason, moving from circuit switch to IP.
- (9) Whatever the reason, if they're investing
- (10) aggressively and the overall revenue
- (11) requirement was growing, index the day one
- (12) subsidy per line based on the overall revenue
- (13) requirement growth of the incumbent.
- (14) And all that is attempting to do is
- (15) create a rough-justice balancing act so that
- (16) if incumbent is losing a lot of lines and
- (17) they're rate-of-return regulated, the subsidy
- (18) per line skyrockets, the new entrant shouldn't
- (19) get the higher amount going forward. But if
- (20) the incumbent is investing a lot to upgrade
- (21) their infrastructure, then presumably someone
- (22) else who's going to try to compete is going to
- (23) also have to upgrade their infrastructure.
- (24) And so that was the indexing that we put
- (25) forward.

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- (1) So, my question for Dennis is, is
- (2) that the kind of indexing you were talking
- (3) about, because when I'm listening to some of
- (4) the respondents on the panel, I hear some
- (5) people saying that they really can't support
- (6) that concept? But my question is, if you
- (7) bifurcated it the way I have just done, do
- (8) people have a different view in terms of
- (9) seeing it as a rough-justice solution?
- (10) MR. WELLER: Rather than go back
- (11) through all of that, it might be easier for me
- (12) to explain what exactly I'm proposing.
- (13) First of all, I don't think we
- (14) should - first of all if we adopt my earlier
- (15) proposal of one ETC per area, then the issue
- (16) of bifurcation becomes moot. Where we haven't
- (17) done that, I don't think we should be
- (18) bifurcating. I think we should always be the
- (19) same. I don't think we should be setting up a
- (20) handicapping mechanism. We shouldn't be
- (21) saying to one, you're less efficient and we're
- (22) going to make you a handicap. I don't think
- (23) that's a good idea.
- (24) COMMISSIONER JABER: Excuse me. I'm
- (25) sorry. I just wanted to let you know that the

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- (1) court reporter has signaled that you all need
 (2) to use the microphone a little bit closer.
 (3) Sorry, Madam Chairman.
 (4) MR. WELLER: What we're proposing -
 (5) and I think this is also in answer to your
 (6) question you asked earlier, Commissioner
 (7) Nelson, is that unlike the current overall cap
 (8) on the fund, this would apply to all ETCs in
 (9) all areas, so sort of close that opening in
 (10) the control mechanism.
 (11) Second, it would be specific to each
 (12) area, not averaged over the entire fund. I
 (13) think a funny thing about the incentive
 (14) structure with the current fund is if carrier
 (15) A spends money in year one that affects
 (16) carrier B's draw in year two, and might create
 (17) a little better alignment of interest in
 (18) carrier A's decision, affecting carrier A.
 (19) So, we're proposing specific indexing in each
 (20) area.
 (21) And I already mentioned that there
 (22) might be extraordinary circumstances that
 (23) would require various escape patches or
 (24) safety-valve mechanisms. And I think that is
 (25) actually a better way of dealing with the

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- (1) kind of service issues that Joel was talking
 (2) about, because ultimately all I can do is
 (3) compare to my own company's experience. We've
 (4) lot of lines over the last few years, and
 (5) nobody's given us a guarantee.
 (6) If you look at a lot of market
 (7) estimates, many on Wall Street predict that we
 (8) will have half as many lines in a few years as
 (9) we had a few years ago. And our response is
 (10) to invest more in our network to create more
 (11) value and generate more revenue. And we're
 (12) doing that without any guarantee or without
 (13) any sort of bailout. I think ultimately down
 (14) the line if you're giving rural carriers
 (15) infrastructure grants, you want encourage them
 (16) to do the same thing to get as much value out
 (17) of their network as possible, not as little.
 (18) And you'd have to ask how much
 (19) regulation or interference with their prices
 (20) you want to step in and do, because it might
 (21) interfere with that process. And, again, I
 (22) don't think you want to get in it sort of at
 (23) this stage on the way there, creating separate
 (24) mechanisms for different carriers in different
 (25) markets. I think you need a specific

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- (1) mechanism that pulls each carrier on a
 (2) per-cost standard. It's set on their starting
 (3) point. It's not based on which particular
 (4) cost model we're trying to take things away
 (5) from them, but saying that going forward
 (6) they're going to have to manage their business
 (7) on this basis.
 (8) COMMISSIONER NELSON: Real quickly,
 (9) Joel, and then we'll move on to another
 (10) question.
 (11) MR. LUBIN: Just to clarify, the
 (12) thought process that I shared with you is
 (13) really for a rate-of-return entity. What I
 (14) just described is unnecessary for, let's say,
 (15) an incumbent like Verizon. The reason why
 (16) it's not necessary is because we're using a
 (17) high-cost model. And the high-cost model is a
 (18) forward-looking model, which does not create
 (19) the problem.
 (20) The fundamental problem that we have
 (21) is we're not using a high-cost model to
 (22) independently calculate it. We're using the
 (23) incumbent's embedded cost. And because of
 (24) that and because we're using rate of return,
 (25) that's why we see the phenomena and the

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- (1) potential risk exposure on wireless expansion.
 (2) And the issue is is there a way to maintain no
 (3) model, rate of return, and create a
 (4) rough-justice balance. That was the question
 (5) I was highlighting.
 (6) COMMISSIONER NELSON: I have a
 (7) question for Dr. Selwyn.
 (8) Dr. Selwyn, in Mr. Reynold's
 (9) testimony he refers to the dubious track
 (10) record of TELRIC. Do you perceive it would be
 (11) more difficult to apply a TELRIC to rural
 (12) carriers having the experience of non-rural
 (13) carriers, or have we learned from that
 (14) experience that would benefit to applying it
 (15) to rural carriers?
 (16) DR. SELWYN: The dubious experience
 (17) with TELRIC is in the eye of the beholder. I
 (18) don't see specifically offhand why would we
 (19) necessarily not be able to construct models
 (20) that would establish some indication of order
 (21) of magnitude for different costs for rural
 (22) carriers given the parameters of their
 (23) circumstances. This is not - quite frankly,
 (24) it's not rocket science.
 (25) These companies, while they each